

**The Florida Senate**  
**BILL ANALYSIS AND FISCAL IMPACT STATEMENT**

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Community Affairs Committee

BILL: CS/SB 1078

INTRODUCER: Governmental Oversight and Accountability Committee and Senator Ring

SUBJECT: State Financial Matters

DATE: March 9, 2010

REVISED: \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Wilson	Wilson	GO	<b>Fav/CS</b>
2.	Gizzi	Yeatman	CA	<b>Fav/1 amendment</b>
3.			GA	
4.			WPSC	
5.				
6.				

**Please see Section VIII. for Additional Information:**

- |                              |                                     |   |
|------------------------------|-------------------------------------|---|
| A. COMMITTEE SUBSTITUTE..... | <input checked="" type="checkbox"/> | Statement of Substantial Changes        |
| B. AMENDMENTS.....           | <input checked="" type="checkbox"/> | Technical amendments were recommended   |
|                              | <input type="checkbox"/>            | Amendments were recommended             |
|                              | <input type="checkbox"/>            | Significant amendments were recommended |

**I. Summary:**

This committee substitute (CS) makes a number of conforming changes to the optional defined contribution pension plan in the Florida Retirement System on the proper nomenclature of the plan, how participant communications are disseminated, the retention and recognition of excess account balances, the retention of participant records by the third-party administrator, the duration of retained participant forfeiture amounts, the liability for extraordinary acts that result in participant losses, and the ownership of intellectual property for products developed by the Board of Administration (Board).

The CS also reduces the administrative service charges and educational expenses payable by participating employers and authorizes the Board to increase the allocation of its asset base to foreign equities from 25 to 35 percent.

For the purposes of making timely notification to the Trustees on matters affecting the liquidity status of the Participant Local Government Investment Pool, the Executive Director of the Board may extend moratoria on contributions or withdrawals until the next earliest opportunity for the Trustees to meet.

This CS substantially amends, creates, or repeals the following sections of the Florida Statutes: ss. 121.4501; 121.4502; 121.591; 121.74; 121.78; 215.47; and 218.409. The CS also creates one undesignated section of law.

## **II. Present Situation:**

The Board of Administration (Board), composed of the Governor, Chief Financial Officer, and Attorney General, is an off-budget state agency created by Art. IX, s. 16, *Constitution of 1885* and continued by Art. IV, s. 9, State Constitution. The Board manages 36 separate statutory investment portfolios, the largest one of which is the multi-employer Florida Retirement System (FRS), the Nation's fourth largest pension plan. Since 1999, the FRS has been partitioned into two separate benefits types: a defined benefit, or percent of final pay ("Pension") plan with a guaranteed annuitized benefit at retirement, and an equity, or defined contribution ("Investment") plan in which assets are self-directed by the participant. Participating public employers make all payroll contributions and there is no employee participation or cost sharing. The Board manages all of the assets of both plans but benefit payments in the Pension Plan are the responsibility of the Division of Retirement in the Department of Management Services.

When first deployed, the Investment Plan was officially entitled the Public Employees Optional Retirement Program (PEORP), a name which has endured in the statutes but has gradually been replaced by the more common terms "Investment Plan" or "defined contribution plan." As this plan has gathered administrative experience over the intervening ten years it has developed a body of practice that, from time-to-time, requires a recodification of its authorizing statutes. At the end of 2009 the Investment Plan had 123,000 total participant accounts and \$4.8 billion in assets.

## **III. Effect of Proposed Changes:**

The CS represents altered administrative practices as well as financial policy changes for accountable parties responsible for gains and losses in participant accounts under defined circumstances. The CS also makes procedural changes to the time frame for extraordinary meetings of the Trustees relative to the authority provided in s. 218.409, F.S., in their management of a multi-employer pooled cash management account. Rapid depletions from the corpus of that account in late 2007 required suspension of participant employer redemptions until its liquidity could be reestablished.

**Section 1** amends s. 121.4501(4), F.S., to provide nomenclature, grammar, mood, and syntax changes and definition amendments for terms used under the FRS Investment Plan in ch. 121, F.S. The responsible state agencies are uniformly designated by their short titles of "department," "division," or "board, or "optional program," the latter in lieu of PEORP.

Persons transferring membership from the Investment Plan to the Pension Plan who have excess account balances may not receive a distribution of the excess until retirement although they may allocate the excess to the purchase of extra service credit.

Subsection (8) is amended to give clearer specific authorization to the Board to adopt rules to execute its statutory duties on the management of the Investment Plan and to develop procedures

for the receipt and action on participant complaints on the plan administrator or vendors. The retained third-party administrator is required to have a records retention capability of at least five years. Actions on complaints greater than five years are presumed to be correct unless the participant can present written or recorded documentation to the contrary.

**Section 2** adds subsection (2) to s.121.4502, F.S., to authorize the creation of a subaccount for the holding of amounts forfeited by participants. The account must be managed consistent with standards established by the Internal Revenue Service and must reduce the forfeited balances by the end of the fiscal year.

**Section 3** amends s. 121.591, F.S., to recognize forms of communication other than written applications for the receipt of benefits.

**Section 4** amends s. 121.74, F.S., to reduce the employer-paid administrative and educational expense charges from .05 to .03 percent of payroll, effective July 1, 2010, through June 30, 2014. On July 1, 2014, the amount is raised from .03 to .04 percent.

**Section 5** amends s. 121.78, F.S., to make nomenclature changes to the references to the participating units of government and also to indemnify the state agencies responsible for posting contributions to an employee account if they are delayed due to acts beyond their control.

**Section 6** amends s. 215.47, F.S., to permit the Board to invest in debt instruments authorized by the Hurricane Catastrophe Fund under s. 215.555(6), F.S., and to use the proceeds of debt issued under s. 215.555, F.S., to purchase authorized and registered securities. This section also authorizes an increase from 25 to 35 percent in the permitted holdings of foreign securities in its investment portfolios.

**Section 7** amends s. 218.409, F.S., to permit an extension beyond the current forty-eight hour moratorium on withdrawals and contributions to the Local Government Investment Pool, since renamed *Florida Prime*, managed by the Board when an emergency meeting of the Trustees cannot be convened within that time frame.

**Section 8** provides that the Board is authorized to develop work products that may be subject to various forms of intellectual property protections under its several statutory mandates and to license and enforce any of those protections on behalf of any of the separate trusts which may have been developed.

**Section 9** provides that this CS shall take effect on July 1, 2010.

**Other Potential Implications:**

There are indirect effects to units of local government whose individual pension plans have investment policies that adopt the amendments to s. 215.47, F.S., by reference in their special acts or ordinances. This is discussed in greater detail in the Fiscal Impact Statement section below.

**IV. Constitutional Issues:****A. Municipality/County Mandates Restrictions:**

None.

**B. Public Records/Open Meetings Issues:**

None.

**C. Trust Funds Restrictions:**

None.

**V. Fiscal Impact Statement:****A. Tax/Fee Issues:**

None.

**B. Private Sector Impact:**

The expansion of portfolio limits into foreign asset classes will provide additional income opportunities to the managers retained for those classes given the higher expense structure to maintain those assets. To the extent that there is a rebalancing of portfolios within the equity classes, foreign and domestic, the lower fees associated with domestic equity management will constitute an increase in expenses to the plan sponsor.

**C. Government Sector Impact:**

Section 218.415, F.S., requires local governments to have an investment policy statement that guides the allocations of their funds not needed for immediate expenditure. In the absence of a written statement, a local government is restricted in its authorized investments. There are nearly 500 local government pension plans in Florida enacted either through special act or local ordinance. An unknown number of them have investment allocation standards that cross reference s. 215.47, F.S. One effect of the change to this section will permit, but not mandate, such plans to change their asset allocation concentration limits to increase their foreign asset holdings. Foreign markets tend to be more opaque, the securities have higher transaction costs, and the demands on local plan management will be more pronounced. Extra caution will have to be exercised by these smaller plans, many of whom already have pronounced declining funded ratios, such that any rapid reallocation of their assets to such markets may increase the volatility and the costs of that decision.

The Board reports that there were 568 participants in the Investment Plan with excess account balances after their transfer from the Pension Plan. Such excesses occur due to superior investment performance above what is required to establish membership. The access to these excess balances is restricted, in part due to the effect of ch. 2009-209, Laws of Florida, as their receipt would constitute a distribution during a period of active service. This violates the Internal Revenue Code and is considered an in-service

distribution and it would further cause the participant to have been effectively “retired,” involuntarily, under state law.

Amendments adopted in committee and incorporated into CS/SB 1078 authorize the Board to purchase securities issued on behalf of public jurisdictions that are influenced by interest rate subsidies authorized under federal law. The most prominent of these are Build America Bonds. Less prominent are those authorized under pending federal legislation passed by the United States Senate on February 24, 2010. These Qualified School Construction Bonds would make an additional \$11 billion available for institutional investors. This authorization is not a purchase mandate and the Board would be required to complete its due diligence review that confirmed these were securities suitable for purchase for its investment portfolios.

The Board also reports that the balances in the forfeiture account have suppressed the amounts employers would have been required to pay for the administrative and education expenses of the Investment Plan. The reduction in the administrative portion expenses contemplates the use of the forfeiture balances in the near term. As of July 1, 2009, the administrative trust fund balance was some \$34 MM. With a forfeiture balance for FY 2010 of some \$10 MM, a beginning balance of \$4.9 MM with cash inflows of \$8.5 MM, the reduction from .05 to .03 percent would not present any funding impairments.

The reduction in employer administrative and educational expense charges of approximately \$9.45 MM will be savings passed along to the participating 964 FRS employers in direct proportion to their share of payroll. Membership composition as of June 30, 2009, is as follows:

District School Boards	48%
State Agencies	21%
Counties	23%
Cities & Special Districts	4%
Community Colleges	3%

## VI. Technical Deficiencies:

There is a grammatical error in section 8, line 571 of the CS; the word “to” should be added so that subsection (4) reads: “Enforce the collection of any sums due *to* the board ....”

## VII. Related Issues:

On March 3, 2010, the Board received a presentation from one of its external consultants, Ennis Knupp, on factors to consider in the development of a revised investment policy statement for the defined benefit plan. The consultant’s presentation, entitled *Asset/Liability Study for the Florida Retirement System Defined Benefit Program*, provided several scenarios in which there is a significant reallocation of plan assets out of equities into fixed income securities. The effect will be to reduce long term growth opportunities, moderate volatility, and permit the servicing of liquidity needs of the plan as it matures and experiences rising claims for retirement benefit payments. On August 13, 2009, the Board requested a private letter Ruling from the Internal Revenue Service on the appropriateness of its hurricane bonds as governmental issuances. In anticipation of a

favorable ruling, the provisions of s. 6 of this CS permit proceeds of these debt issuances to be invested in other governmental securities. These two different events have a common thread. It will be essential for the Board to demonstrate that these post-event catastrophe bonds maintain their tax-exempt status in the event of a significant weather event prompting their issuance. Because the Board is also the market-maker of these securities by law it will be essential to demonstrate that any purchase of such fixed income securities by any of the other asset classes it manages is also reasonable, prudent, and for the sole and exclusive benefit of the participants.

## **VIII. Additional Information:**

- A. **Committee Substitute – Statement of Substantial Changes:**  
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

### **CS by Governmental Oversight and Accountability Committee on March 2, 2010:**

The Committee Substitute expands the authority of the Board to purchase debt securities issued incidental to federal law changes authorizing infrastructure and school facility construction bonds.

- B. **Amendments:**

### **Barcode 174480 by Community Affairs Committee on March 9, 2010:**

This technical amendment, adds the word “to” on line 571 of CS/SB 1078, when referring to collections due to the board in subsection (4).